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# BDO World Wide Tax News

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## BDO World Wide Tax News

Issue No. 2 / 09 - July 2009

Welcome to Issue 2009 No. 2 of *BDO World Wide Tax News*. This newsletter summarises important recent tax developments of international interest across the world. If you would like more information on any of the items featured, or would like to discuss their implications for you or your business, please contact the person named under the item(s). The material discussed in this newsletter is meant to provide general information only and should not be acted upon without first obtaining professional advice tailored to your particular needs. *BDO World Wide Tax News* is published quarterly by BDO Global Coordination BV in Brussels. If you have any comments or suggestions concerning *BDO World Wide Tax News*, please contact the editor, Zigurds Kronbergs, by e-mail at [zkronbergs@bdoglobal.com](mailto:zkronbergs@bdoglobal.com) or by telephone on +32 (0)2 778 0141.



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## United States

# Administration's international tax reforms

On 11 May 2009, the US Treasury Department released *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals* (the 'Green Book'), a document that provides a description of the Obama Administration's budget proposals affecting revenues. In a 4 May 2009 news release, President Obama had announced, and the US Treasury Department had outlined, a sweeping tax-reform proposal that would, if enacted, affect almost all US taxpayers conducting international activities and/or having international investments. These provisions are explained in further detail in the Green Book. A significant portion of the anticipated tax revenue resulting from the reforms (estimated at more than USD 210 000 million between 2011 and 2019) is proposed to provide an offset for any potential revenue losses from making the research credit permanent.

There follows a summary of the proposed changes affecting the international taxation arena (unless otherwise stated, these proposals would be effective for taxable years beginning after 31 December 2010):

- **Continuation of Certain Expiring Provisions through Calendar Year 2010.** Certain expiring provisions, including the subpart-F 'active financing' and 'look-through' exceptions, would be extended an additional year to 31 December 2010 (currently, these rules are set to expire on 31 December 2009).
- **Reforming the entity classification ('check-the-box') rules.** If a foreign eligible entity is owned by a single owner, it will be treated as disregarded *only* if that single owner and its foreign eligible entity are both organised in the same foreign country. If a single-member foreign eligible entity is created or organised outside its owner's home country, the disregarded entity would instead be treated as a foreign corporation for federal tax purposes. This rule is not intended to affect elections by a first-tier foreign eligible entity, i.e. one owned directly by the US person, unless it was formed for tax-avoidance purposes. This proposal would constitute a significant change under the rules for international tax planning that have been available for most US taxpayers since 1997. The change in classification from a disregarded entity to a corporation would be subject to any existing tax provisions that otherwise apply to a corporate-conversion transaction. The proposal makes no reference to foreign eligible entities with multiple owners.

- **Prevention of foreign tax credit abuse.** Rather than continue the application of the foreign tax credit limitation separately to foreign-source income in each of the separate categories under IRC section 904(d), the proposal would determine the deemed-paid foreign tax credit for a taxable year based on the amount of the consolidated earnings and profits of the foreign subsidiaries repatriated to the US taxpayer in that particular taxable year. Thus, the aggregate foreign taxes and earnings and profits of all the foreign subsidiaries on a consolidated basis would determine the deemed-paid foreign tax credit.
- **Matching rule.** In addition to the change to the deemed-paid credit, a matching rule has been proposed to prevent the separation of creditable foreign taxes from the associated foreign-source income.
- **Modification of the tax rules for dual-capacity taxpayers.** The proposal would change the foreign tax credit with respect to dual-capacity taxpayers (taxpayers that are subject to a foreign levy and also receive a specific economic benefit from the levying country) so that a foreign levy that otherwise qualifies as an income tax or in-lieu-of tax would only be creditable if the foreign country generally imposes an income tax. Because there is no separate foreign tax credit category under current law for foreign oil and gas income, the proposal would convert the special foreign tax credit limitation rules of IRC section 907 into a separate category within IRC section 904 for foreign oil and gas income.
- **Restriction or deferment of certain deductions.** These changes would apply to deductions (other than research and experimentation expenditures) such as interest expense and other expenses that are properly allocated and apportioned to foreign-source income to the extent that the foreign-source income associated with the expenses is not currently subject to US tax.
- **Limitation of shifting of income through intangible property.** The definition of intangible property for purposes of IRC section 367(d) (transfers to a foreign corporation) and section 482 (allocation of income and deductions among taxpayers) would be amended to include certain intangibles such as workforce in place, goodwill, and going-concern value to prevent the inappropriate shifting of income outside the United States.
- **Tightening of earnings-stripping limitation as related to expatriated entities.** Current law limits the deductibility of certain interest paid by a corporation to related foreign persons. This limitation applies when a corporation's debt-to-equity ratio is greater than 1.5 to 1 (the 'safe harbour' ratio) and the net interest expense is in excess of 50% of the adjusted taxable income. The proposed rule will eliminate the debt-to-equity safe-harbour provisions and reduce the net interest expense percentage to 25% of adjusted taxable income with respect to disqualified interest paid to expatriated entities other than interest paid to unrelated parties on debt that is subject to related-party guarantee.



- **Prevention of repatriation of earnings in certain cross-border reorganisations.** Current law allows foreign earnings not previously taxed in the United States to be repatriated to US shareholders with minimal US tax consequences in some instances because of the 'boot-within-gain' limitation under IRC section 356(a)(1). The repeal of the boot-within-gain limitation has been proposed for reorganisations in which the acquiring corporation is foreign and the shareholder's exchange has the effect of the distribution of a dividend. This provision appears to affect certain 'all-cash' or 'all-boot' 'D' reorganisations where the acquirer is foreign.

- **Repeal of 80/20 company rules.** Under current law, IRC section 861(c) provides that if at least 80% of a domestic corporation's gross income during a three-year testing period is foreign-source and attributable to the active conduct of a foreign trade or business (so that the company is a so-called '80/20' company), a limited exception applies to prevent dividends and interest paid by such a company from being treated as US-source income and thus subject to gross-basis withholding tax if paid to a foreign person. The 80/20 provision would be repealed under the proposal.

- **Treatment of income earned by foreign persons with respect to equity swaps as US-source to the extent that income is attributable to dividends paid by a domestic corporation (subject to certain exceptions).** Current law provides that income from notional principal contracts is generally sourced to the residence of the investor, resulting in the treatment of substitute dividend payments made to a foreign investor with respect to an equity swap referencing US equities as foreign-source and thereby not subject to US withholding tax. The proposal would repeal Notice 99-66 and re-source such income to the United States, to the extent that the income

is attributable to dividends paid by a domestic corporation. The proposal would be effective for taxable years beginning after 31 December 31 of the year of enactment.

- **Increase in penalties for failure to report overseas investments or financial accounts.** This will be accomplished by extending the statute of limitations to six years after the taxpayer provides the required information.

- **Qualified Intermediary ('QI') Provisions.**

Reforms to be enacted will strengthen the enforcement of tax laws by expanding the requirements of the QI programme. Separately, the Administration plans to provide additional resources (including 800 new IRS personnel) for the enforcement of the international tax rules. Some key proposals relating to QIs and non-QIs are:

- Prohibiting the qualification of a foreign financial institution as a QI unless it identifies all of its account holders that are US persons
- Requiring that all payments of fixed, determinable, annual, and periodic income to a non-qualified intermediary be treated as a payment to an unknown foreign person and thus subject to 30% withholding tax. A refund mechanism for over-withholding would be permitted for foreign persons.
- Requiring that tax at a rate of 20% be withheld on the gross proceeds from the sale of any security of a type that would be reported to a US non-exempt payee, when paid to a non-qualified intermediary located in a jurisdiction with which the United States does not have a comprehensive income tax treaty.

These proposals would be effective for payments made after 31 December 31 of the year of enactment.



Other proposed changes include:

- Requiring US individuals to report any transfer of money or property (in excess of USD 10 000) made to, or received from, any foreign bank, brokerage, or other financial account by the individual, or by any entity in which the individual owns more than 50%
- Requiring individual taxpayers who are required to file an annual reporting of a foreign bank account (Form TD F 90-22.1 or 'FBAR') also to disclose certain information on a schedule as part of the individual's income tax return
- Requiring third-party information reporting regarding the transfer of assets to foreign financial accounts and the establishment of foreign financial accounts
- Requiring third-party information reporting regarding the establishment of offshore entities
- Establishing rebuttable evidentiary presumption with respect to foreign accounts for which an FBAR has not been filed
- Establishing rebuttable evidentiary presumption with respect to failure to file an FBAR for accounts with non-qualified intermediaries
- Doubling the accuracy-related penalties on understatements involving undisclosed foreign accounts (the proposed penalty would be 40% when the understatement arises from a transaction involving a foreign account that the taxpayer failed to disclose properly under the proposed requirement that taxpayers disclose FBAR-related information on their income tax returns)
- Improving and increasing the foreign-trust reporting penalty by increasing the initial penalty to the greater of USD 10 000 and 35% of the gross reportable amount.

Any proposals will require passage by both houses of Congress before they are enacted into law. The legislative process may take significant time as the proposed changes affect many current Internal Revenue Code provisions, and members of Congress may not support the precise proposals made by the Administration. Thus, the timing of approval of any legislation (in the form of the Treasury proposal or any other form) and signature by the President cannot be known.

The proposed reforms did not state any specific changes to or repeal of, the controlled foreign corporation (CFC) rules including subpart-F (except for the one-year extension of certain subpart-F temporary provisions). However, the proposed changes to the check-the-box rules may create situations where taxpayers may in fact be subject to the application of the subpart-F rules in 2011 and thereafter. Many taxpayers had previously avoided creating subpart-F exposure by affirmatively using check-the-box tax planning in their offshore structures. No transition rules are provided to allow taxpayers to restructure their operations without triggering a number of adverse consequences related to any change in the US tax status of the foreign subsidiaries. Currently a decision to uncheck the box by taxpayers may trigger significant tax consequences. The sweeping nature of the provisions and the proposed effective date (taxable years beginning after 31 December 2010) provide a relatively short window of opportunity for taxpayers to take into account the impact of the provisions and to implement any planning needed to work within the new rules.

The repeal or major reform of the check-the-box rules may have a significant impact on S-corporations and partnerships (including limited-liability companies (LLCs) classified as partnerships), which are ultimately owned by US individuals and are taxed on the individual owners' income tax returns. A full repeal would likely result in increased double taxation of foreign income (once in the foreign jurisdiction and again in the United States) as individual taxpayers in the United States are not given the ability to avail themselves of the indirect tax credit mechanism for any foreign corporate tax paid by a foreign subsidiary. Historically, corporations taxed as C-corporations have been provided the ability to claim local foreign taxes as a foreign tax credit as an indirect credit under section 902. This disparity may increase the effective tax rate on the income of S-corporations or partnerships (including LLCs taxed as partnerships) currently conducting business outside the United States through the use of the check-the-box rules.

The tracking of deferred deductions in addition to the change in the deemed-paid (indirect) foreign tax credit will require additional recordkeeping and tracking by taxpayers to determine their foreign tax credits and limitation amounts available for future taxable years.

Among administrative and domestic reforms that may also be of interest are the following:

- **Codification of the ‘Economic Substance’**

**Doctrine.** The common-law ‘economic substance’ doctrine generally denies tax benefits from a transaction that does not meaningfully change a taxpayer’s economic position, other than tax consequences, even if the transaction literally satisfies the requirements of the Internal Revenue Code. Although courts have applied the economic-substance doctrine with increasing frequency, they have not applied it uniformly. The proposal would provide that a transaction satisfies the economic-substance doctrine only if (a) it changes in a meaningful way (apart from federal tax effects) the taxpayer’s economic position and (b) the taxpayer has a substantial purpose (other than a federal tax purpose) for entering into the transaction. The proposal would also clarify that a transaction will not be treated as having economic substance solely by reason of a profit potential unless the present value of the reasonably expected pre-tax profit is substantial in relation to the present value of the net federal tax benefits arising from the transaction. In addition, the proposal would impose a 30% penalty on an understatement of tax attributable to a transaction that lacks economic substance, reduced to 20% if there was adequate disclosure of the relevant facts in the taxpayer’s return. The proposed penalty would be imposed with regard to an understatement due to a transaction’s lack of economic substance in lieu of other accuracy-related penalties. Finally, the proposal would deny a deduction for interest attributable to an understatement of tax arising from the application of the economic-substance doctrine. The proposal would apply to transactions entered into after the date of enactment. The proposed denial of interest deductions would be effective for taxable years ending after the date of enactment with respect to transactions entered into after such date.

- **Permanent Extension of the Research and Experimentation (R&E) Tax Credit.**

Under current law, the R&E tax credit expires on 31 December 2009. The R&E tax credit is 20% of qualified research expenses above a base amount. The base amount is the product of the taxpayer’s average gross receipts for the four preceding years and the ratio of its research expenses to gross receipts for the 1984-88 period. The base amount cannot be less than 50% of the taxpayer’s qualified research expenses for the taxable year. Taxpayers can elect the alternative simplified research credit, which is equal to 14% of qualified research expenses that exceed 50% of the average qualified research expenses for the three preceding taxable years. The proposal would make the R&E tax credit permanent.

- **Expansion of the Net Operating Loss (NOL)**

**Carry-back.** Under current law, for taxpayers other than certain eligible small businesses, a NOL may generally be carried back two years and carried forward 20 years to offset taxable income in such years. The American Recovery and Reinvestment Act 2009 allows certain eligible small businesses whose average annual gross receipts do not exceed USD 15 million to elect to carry back NOLs arising in 2008 for three, four or five taxable years. The Administration proposes to work with Congress to make an expanded carry-back provision available to more taxpayers, but does not make a specific proposal.

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## North America and the Caribbean Canada

# Canada active in negotiating TIEAs

In May 2009, the Canadian government confirmed that negotiations are under way with Bermuda, Guernsey, Jersey, the Isle of Man and the Netherlands Antilles to enter into Tax Information Exchange Agreements (TIEAs) with those jurisdictions. Bermuda has stated that it has concluded negotiations on a TIEA with Canada although this has yet to be confirmed by the Canadian government. These negotiations are the first indication that Canada is actively pursuing these agreements with non-treaty partners.

TIEAs establish the terms under which Canada and the other party help each other administer and enforce their domestic tax laws through the exchange of relevant information. For countries with which Canada has no tax treaty, TIEAs are important to ensure that Canada can obtain sufficient information to enforce its tax laws and combat tax evasion.

There are tangible benefits to a jurisdiction that enters into a TIEA with Canada. Under the Canadian tax system, dividends received by a Canadian company out of active business income earned by foreign affiliates resident in countries that have a tax treaty with Canada are exempt from Canadian tax. In 2007, Canada announced that this exemption would be extended to include active business income earned by a foreign affiliate residing in a country that has entered into a TIEA with Canada.

In addition, if a country is approached but does not conclude a TIEA with Canada within five years of the date on which Canada proposed the negotiations, active business income earned in a foreign affiliate resident in that jurisdiction will be taxed on an accrual basis in Canada (currently this income would only be taxed if it is paid to the Canadian parent company as a dividend).

An advisory panel to the Canadian government on Canada's international tax system recommended in its report issued in December 2008 that Canada broaden the existing exemption system to cover all foreign active business income earned by foreign affiliates. This would mean that all dividends received by Canadian parent companies from foreign affiliates would be exempt from Canadian tax, no matter in which jurisdiction the foreign affiliate is located. If this recommendation were to be adopted by the Canadian government, it would effectively eliminate the incentive for non-treaty jurisdictions to enter into a TIEA with Canada. In May, the Canadian government hinted that this recommendation would likely be put on hold until Canada had successfully entered into TIEAs with jurisdictions with which Canada feels it is important to have a TIEA.

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## Mexico

As a result of the global financial crisis, various tax measures have been enacted across the Americas in an effort to raise fiscal revenue and promote capital inflows. Traditionally, many governments in Latin America have often resorted to measures such as tax amnesties and other provisions to raise additional revenue. The Mexican government has enacted fiscal measures in order to further the above objectives of raising revenue through partial fiscal amnesty and promoting financial inflows into the Mexican financial system. These objectives were achieved on 26 March 2009, when the Mexican government enacted the 'Decree granting several fiscal benefits related to the Income Tax for deposits or investments that are repatriated to Mexico'.

The purpose of the Decree is to grant a tax benefit to taxpayers, both individuals and legal entities, that have received income from investments abroad made prior to 1 January 2009, and who have repatriated such funds to Mexico, on the condition that the funds be invested and remain in Mexico for a minimum period of two years from the date on which they are repatriated. There is an exception for income that corresponds to items that have been previously deducted by a resident in Mexico. To be eligible for the benefit, the resources must be repatriated while the Decree remains in force. Additionally, the following taxpayers are not eligible for the benefits under the Decree:

- taxpayers subject to a tax audit prior to the date on which they must make the payment of income tax or
- taxpayers that have initiated an appeal, nullity trial, or amparo appeal in connection to such items of income.



The tax benefit under the decree is a reduced tax rate of 4% for individuals and 7% for legal entities, in each case based on the amount repatriated, without any deduction. The reduced tax rate is available only in the case of a repatriation of an investment that has been maintained abroad, directly or indirectly, prior to 1 January 2009. The payment of the tax will be made with the acquisition of stamps in banks or stock markets in Mexico, within 15 calendar days of the date of the cash repatriation. The statutory rate of income tax is generally 28%.

The stamps must fulfil specific requirements (date of acquisition, amount of tax paid, name or trade name, signature of those who acquire said stamps, and seal of the credit institution or stock exchanges). If these requirements are not fulfilled, the payment will not have any legal effect.

Legal entities have the obligation to file a letter with the SAT (Mexican tax authority) within 15 days of the payment of the tax, indicating:

- Trade name, legal address, and RFC code (tax ID number)
- Date and amount of the resources returned to the country
- Amount of any tax paid and
- Folio of the acquired stamps

Additionally, legal entities must add the profit that corresponds to the repatriated resources to their taxable earnings account or *Cuenta de Utilidad Fiscal Neta* 'CUFIN'), which will be decreased by the income tax paid according to the terms of the decree, as follows:

Furthermore, the taxable profit determined must also be used to determine the taxable income that serves as a base for the determination of the PTU (Participation of Workers in Profits) or profits sharing tax.

In accordance with the terms of the decree, the amount of the income tax paid will not be creditable against the Flat Rate Business Tax (IETU). In addition, the benefits derived from the application of the Decree are not considered to be taxable for income tax purposes, and application of the benefits cannot give rise to refunds, credits, or any type of compensation.

The formal tax obligations related to the income subject to the application of the Decree will be considered to be fulfilled, provided that the formal requirements in the rules of the Decree itself are fulfilled.



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#### Fiscal profit that corresponds to the repatriated resources

<b>Minus</b>	Tax paid for the repatriated resources
<b>Equals</b>	Amount to add to the balance of the CUFIN

## United States of America

See page 1.

## Europe and the Mediterranean European Union

### **ECJ Gibraltar decision under appeal**

See under Gibraltar.

### **Netherlands withholding tax exemption must apply to Iceland and Norway**

See under Netherlands.



## Belgium

# Dividends-received deduction extended

The Belgian government has announced how it will comply with the decision of the European Court of Justice (ECJ) in the *Cobelfret* case concerning its deduction for dividends received by companies.

As reported in *BDO World Wide News 2009/1*, the ECJ held in *Cobelfret* that Belgium was in breach of the EC Parent Subsidiary Directive (90/435/EEC) in the method by which it exempted 95% of dividends received. Essentially, the exemption was effected by including 100% of dividends received in taxable income and then deducting 95%. However, to the extent that taxable income was insufficient, the deduction could not be made. As a result of the ECJ's decision, Belgian companies affected by the rule now have excess dividends-received deduction (DRD) brought forward, in respect of dividends that they ought to have been, but were not, able to deduct.

The rules for claiming this excess DRD stipulate as follows:

- Excess DRD brought forward applies to qualifying dividends from companies resident in EU Member States as from 1 January 1992 and from other EEA states (Iceland, Liechtenstein and Norway) as from 1 January 1994

- There is no excess DRD in respect of dividends from non-EEA countries, as the ECJ decision does not apply to them
- Excess DRD brought forward qualifies for deduction in the current year to the extent that the minimum participation (shareholding) requirement was met at the time the dividend was received
- When a company has dividends from both EEA and non-EEA companies, it must first deduct the non-EEA dividends (but under the old rule, so these deductions cannot exceed taxable income) but the full 95% deduction for current-year EEA dividends may then be made, regardless of the amount of taxable income remaining
- Excess DRD brought forward must be deducted before deductions for notional interest and patent income and any trading losses brought forward

Note that a separate case is proceeding in the Belgian courts concerning the lawfulness or otherwise under Community law of the old deduction rule as it applies to non-EEA dividends. Protective action to preserve or establish a claim for the maximum deduction for such dividends also should therefore be considered.



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## Denmark

# Tax reform enacted

Denmark's corporate tax reform was finally enacted on 28 May. The final measures were substantially similar to the proposals on which we reported in the last issue of *BDO World Wide Tax News*. The main changes made by the Act involve the taxation of dividends and capital gains on shares.

### Group, subsidiary and portfolio shares

The new rules classify shares held by one company in another into one of three categories.

'Group shares' are shares in respect of which both investor and investee companies are in the same tax group, i.e. subject to mandatory tax consolidation as between Danish companies, subject to elective international tax consolidation as between Danish and foreign companies, or eligible for elective international tax consolidation but not currently subject to such consolidation. Normally, for a qualifying group relationship to exist, the parent company must directly or indirectly control more than 50% of the voting power in the other group members (but see 'Group definition changes' below).

'Subsidiary' shares are shares belonging to a direct holding of at least 10% in the investee company and, if that company is foreign, where the holding is a qualifying holding under the EC Parent-Subsidiary Directive or one qualifying for reduced withholding tax under a tax treaty between Denmark and the investee company's home state.

'Portfolio shares' are all other shares.

### Taxation of share income and gains

Under the new rules, dividends and capital gains from group and subsidiary shares will be exempt from

Danish corporate tax, without any minimum holding period, as will group contributions; capital losses from these shares will not be recognised for tax purposes.

An anti-avoidance rule has been introduced to prevent circumvention of the capital and voting-power criteria by interposing intermediate holding companies.

Income and gains from portfolio shares, on the other hand, will be fully taxable, whatever the holding period. Capital losses will be allowable. What is more, gains and losses on portfolio shares will be recognised on a mark-to-market basis, whether or not there has actually been a disposal. In the case of unquoted shares, however, companies may elect for the normal realisation basis, provided that the election covers all unquoted shares.

The base value for computing the mark-to-market gains and losses will be the fair market value as at 1 January 2010. However, if a company's aggregate acquisition cost on its portfolio shares exceeds this opening base value, the excess may be carried forward as a loss to set off against gains from portfolio shares, under certain conditions. Additionally, any tax-exempt gains under the current rules on disposals of portfolio shares between 25 May 2009 and 31 December 2009 will reduce the amount of this loss carried forward.

### Phasing-in of tightened interest restriction

Under Denmark's rules for restricting the deduction of related-party interest payments, a Danish company may not deduct net financing expenses to the extent that they exceed either:

- 80% of EBIT (earnings before interest and tax) or
- 6.5% (2009 value) of qualifying assets

Net financing expenses of less than DMK 21.3 million (2009 value; EUR 2.86 million; USD 3.78 million) may be deducted in any case. Included in qualifying assets is 20% of the acquisition cost of direct holdings in foreign subsidiaries. This 20% is to be reduced to zero, over a period of seven years beginning in 2010.

### **Dividend withholding tax**

The standard rate of withholding tax on dividends is reduced from 28% to 27%, and the one-year minimum holding period for exemption from withholding tax for holdings of at least 10% is removed.

### **Mark-to-market taxation of loan relationships**

As from 2010, gains and losses on a company's loan relationships (both as borrower and as lender) will be computed on a mark-to-market basis, with the exception of trade debtors and trade creditors.

### **Tax-exempt restructuring**

For company reconstructions (exchanges of shares, demergers, transfers of assets) carried out after 21 April 2009 without prior clearance from the tax authorities, the previous dividend limitation has been replaced by a three-year minimum holding period. That is to say, if any of the following shares are disposed of within three years of the reconstruction, the gain on reconstruction becomes taxable. The shares in question are:

- Share exchanges — all the acquiring (transferee) company's shares in the acquired (transferor) company
- Demergers — shares held by companies that subsequent to the demerger hold at least 10% of the shares in either the transferor (demerging) company or in the transferee companies
- Transfers of assets — all the shares received in exchange by the company transferring the assets in the company receiving the assets

Where a reconstruction was carried out without prior clearance before 22 April 2009, the dividend limitation is to be removed in 2010, but the three-year holding period will not apply.

### **Group definition changes**

As a result of the new Companies Act also passed on 29 May, the definition of what constitutes a group of companies has been harmonised across company law, accounting law and tax law.

As stated earlier, the essential criterion for a group has been that it consists of the parent company and all other companies in which it directly or indirectly holds more than 50% of the voting power. Now, however, even where there is a holding of 50% or less, a group includes companies over which the parent exercises 'decisive influence'. This will be the case where the parent company:

- can exercise more than 50% of the voting power by virtue of an agreement with other shareholders or
- has the authority by virtue of the statutes or by agreement to control the financial and operating activities of the company concerned or
- has the authority to appoint or dismiss the majority of the members of the management board exercising decisive influence over the company or
- can exercise the actual majority of votes at the general meeting or in a similar assembly and thereby exercises decisive influence

### **Personal tax changes**

Considerable changes have also been made to personal taxation. These will be reported in the next issue of *BDO World Wide Tax News*.

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## Estonia

# VAT rate raised

On 18 June 2009, Estonia's parliament, the Riigikogu, enacted amendments to the VAT Act, raising the standard rate of VAT from 18% to 20%, with effect from 1 July.

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## Gibraltar

# ECJ Gibraltar decision under appeal

In March 2009 two appeals were launched against an earlier decision of the European Court of Justice in relation to Gibraltar's corporate tax reforms. Following an initial ruling by the European Commission on 30 March 2004 (2005/261/EC) that the Government of Gibraltar's tax proposals constituted State Aid, the European Court of First Instance had then on 18 December 2008 annulled the European Commission's decision. In its ruling, the European Court of First Instance referred to the fact that Gibraltar has the procedural, economic and administrative independence from the United Kingdom to allow it to develop its own tax régime (see *BDO World Wide Tax News, Issue 2009/1*).

This is not the end of the story, however. Both the European Commission and Spain have appealed against the December 2008 decision.

On 18 March 2009, the European Commission brought its appeal against the judgment on the basis of how Article 87(1) of the EC Treaty had been applied by the ECJ in the case. The grounds of the European Commission's appeal, however, revolve around how the ECJ has applied the criteria in assessing the issue of material selectivity, i.e. the way that aid provided by a government distorts competition by favouring certain undertakings over others.

From the perspective of the Government of Gibraltar, the concerns over the material selectivity of the original case are no longer relevant, as the Government is no longer seeking to implement the proposals that were originally put to the European Commission, and which are the subject of this new appeal. The new proposed tax régime will involve a flat-rate tax payable by all companies, which should render any concerns in relation to material selectivity redundant.

On 20 March 2009, the Kingdom of Spain brought a second appeal against the ECJ's judgment. This appeal is brought on the crucial issue of regional selectivity, i.e. the ability of the Government of Gibraltar to set its own tax laws different from those of the United Kingdom. In seeking to have the ECJ judgment set aside, Spain is arguing that Gibraltar cannot be treated as a separate Member State for tax purposes, although

it did not raise the issue of regional selectivity in its original case, largely on the basis that it is itself affected, given that different parts of the country have their own tax régimes. The Government of Gibraltar believes that this second appeal has been brought on political grounds, and is confident that it will not succeed.

## Budget changes

Also of note, is that on Thursday 25 June, the Chief Minister announced the Budget for the forthcoming tax year. Key measures in relation to corporate tax include the introduction of a 10% corporate tax rate for all new businesses as of 1 July 2009, which will be taxed on an actual basis. The 10% rate will also be available for companies that commenced trading after 1 July 2007 subject to the satisfaction of certain conditions,

and will be the corporate tax rate for all companies from 1 January 2011. On the personal-tax front, the top rate of tax on the Gross Income Based system has been reduced from 38% to 35% for earnings over GBP 100 000, and the rate of tax on income between GBP 25 000 and GBP 100 000 has been reduced from 30% to 29%. The maximum tax payable by Category Two individuals has been increased marginally.

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## Greece

### EU interest and royalty rate falls to 5%

As part of the transitional arrangements for full compliance with the EC Interest and Royalties Directive (2003/49/EC), the rate of withholding tax on

qualifying payments of interest and royalties decreased to 5% on 1 July 2009. Withholding tax on these payments will be abolished altogether from 1 July 2013.

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## Hungary

# Significant changes to corporate tax

On 29 June 2009, the Hungarian parliament enacted significant amendments to its corporate tax. Most of the amendments will take effect on 1 January 2010, and many will have an impact on inbound investment into and through Hungary. However, the law has yet to be signed by the President and promulgated, so it is possible that details may yet change.

### Rate of corporate tax

Currently, there is a 16% standard rate of corporate tax, but there is also a special solidarity surcharge of 4%. The solidarity surcharge is to be abolished, partly compensated by an increase in the standard rate to 19%.

### Participation exemption

Currently, dividends received by Hungarian companies from abroad are exempt in practice (included in taxable income but then deducted) unless received from a controlled foreign company. Capital gains from the sale of corporate shareholdings are exempt provided that the holding in the investee company is at least 30% and has been held for at least one year. An additional requirement is that the shareholding must have been registered with the tax authorities. Another requirement for both the dividend and capital-gains

exemption is that the investee company be located in an EEA, OECD or treaty-partner jurisdiction.

Under the new rules, foreign dividends received by Hungarian holding companies ultimately owned by foreign individuals would be exempt from Hungarian corporate tax without any further condition. Capital gains derived by such companies from the sale of corporate shareholdings would be exempt wherever the investee company is located, provided that the other conditions (30% ownership, minimum holding period and registration) are met.

### Abolition of half interest deduction

The 50% deduction currently available for interest received from affiliated companies is to be abolished, following a State Aid investigation by the European Commission. The equivalent deduction for royalties from affiliates remains in place, however.

### Withholding tax on interest and royalties

Until now, Hungary has not levied withholding tax on dividends, interest or royalties paid to other companies, whether domestic or foreign. In future, however, a 30% withholding tax would be charged on interest and royalties paid to residents of a jurisdiction with which Hungary does not have a double tax treaty.

## VAT rate increased

In a separate move, Hungary has increased its standard rate of VAT from 20% to 25% (the maximum permitted in the European Union) with effect from 1 July 2009. A reduced rate of 18% will apply to basic foodstuffs

and district heating. What is now the super-reduced rate of 5% continues to apply to books, newspapers, magazines, certain pharmaceutical products and medical preparations for human use.

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## Israel

# Further tax exemption announced to encourage foreign investment

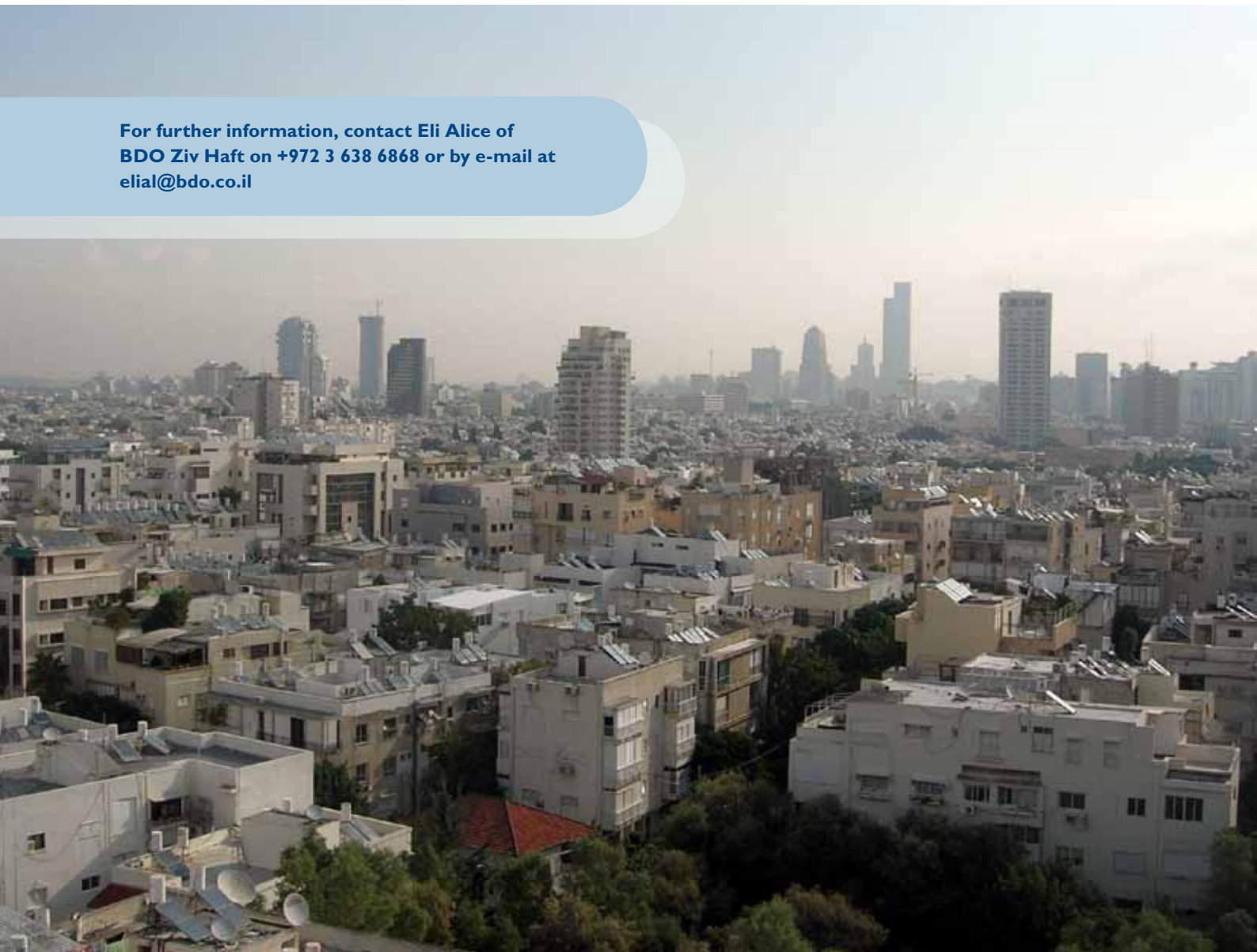
On 26 May, the Israeli Finance Minister announced an exemption for foreign residents on income derived from private equity fund investments. This exemption follows previous tax reforms that came into effect in January 2009, and is dedicated to encouraging foreign investment in Israel at a time of economic uncertainty in the worldwide markets.

Currently foreign investors in private equity funds are taxable at a rate of 15% for individual investors and 25% for corporate investors, whereas for investments in capital venture funds alone, an exemption can be

obtained under certain circumstances. Following the recent expansion of the capital gains tax exemption granted to foreign shareholders to include the sale of non-traded securities of Israeli companies (with the exception of real-estate companies) and debentures, it comes as no surprise that investments in private equity funds should follow suit and be tax-exempt for foreign investors.

The final approval for the exemption is expected shortly and with it the necessary guidelines for its implementation.

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## Kazakhstan

# Wide-ranging changes to tax code

Extensive changes to the Tax Code of Kazakhstan have been made with effect from 1 January 2009 and prospectively. These include:

- Progressive reductions in the rate of corporate income tax — the rate is 20% for 2009, will be 17.5% in 2010 and 15% in 2011
- An increase from 3 to 10 years for the loss carry-forward period
- Withdrawal of the special corporate tax schemes for petrochemical production and high value-added production
- A fixed 11% rate of social security contributions for employers
- A standard rate of 12% for VAT
- The abolition of tax 'grandfathering' for subsoil-use contracts and the substitution of an extraction tax to replace royalties for subsoil users
- Interest deductibility will be unrestricted except where the lender is a related party, or the loan is secured by a related third party, or the lender is a legal entity resident in a tax haven
- A reduction from 20% to 15% for the non-treaty rate of withholding tax on capital gains and royalties
- The introduction of a beneficial-owner requirement for claiming reduced treaty rates on dividends, interest and royalties

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## Latvia

### Personal allowance slashed

As part of the second round of spending cuts for the financial year 2009, in response to the financial crisis, the Latvian parliament has approved the reduction of the personal allowance available to every individual taxpayer from LVL 1080 per year (or LVL 90 per month) to LVL 420 (LVL 35 per month), with effect from 1 July 2009. Also included in the package was an increase in the excise duty on beer and spirits.

However, the idea of introducing a second, higher rate of personal income tax, apparently floated by the Prime Minister, was later categorically ruled out. If tax increases need to be made as part of the deficit-reduction plan for the years 2010 and 2011, the government would consider an increase in the standard rate of VAT from 21% to 23%. The last increase (from 18% to 21%) was made on 1 January 2009.

### EU interest and royalty rate falls to 5%

As part of the transitional arrangements for full compliance with the EC Interest and Royalties Directive (2003/49/EC), the rate of withholding tax on qualifying payments of interest and royalties decreased to 5% on 1 July 2009. Withholding tax on these payments will be abolished altogether from 1 July 2013.

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## Lithuania

### EU interest and royalty rate falls to 5%

Lithuania has waived some of its rights to charge higher rates of withholding tax under the transitional arrangements for full compliance with the EC Interest and Royalties Directive (2003/49/EC). Accordingly, although authorised to deduct tax at 10% on qualifying interest payments until 1 July 2011, it has reduced the rate to 5% with effect from 1 July 2009, and will abolish the withholding tax on interest altogether on 1 July 2011, two years ahead of schedule.

As regards royalties, the withholding tax on qualifying payments has been reduced to 5% from 1 July 2009, as required, but it will be abolished altogether from 1 July 2011, two years ahead of schedule.

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## Morocco

# Budget tax changes

Morocco's 2009 Budget Law has completed the codification of tax legislation and made certain other procedural and assessment changes. Measures contained in the Law can be summarised as concerning:

- Codifying tax legislation
- Various tax measures
- Amending tax procedures

### Codifying the law

The 2009 Budget Law completes the progressive process of consolidation of tax legislation, incorporating measures relating to stamp duty and those relating to the special annual tax on cars in a new section (Book III, Articles 249 to 266) within the General Tax Code (CGI).

### Corporate tax measures

Where general partnerships, limited partnerships established in Morocco and all of whose partners are natural persons, or joint ventures elect to be assessed for corporate tax, that option has become irrevocable.

Companies exporting recovered metals lose the opening five-year exporters' tax exemption and the subsequent reduced tax rate of 17.5% and will henceforth be taxed at the full 30% rate.

The benefit of the flat-rate USD 500 tax for offshore holding companies is restricted to those whose sole purpose is management of the securities portfolio of non-residents and participation in the investee companies.

Companies in existence at 1 January 2009 that increase their share capital in the two years ending 31 December 2010 will receive a reduction of corporate tax equal to 20% of the capital increase.

### Personal tax measures

The rates of income tax for 2009 have been set as follows:

Band of taxable income (MAD)	Tax rate (%)
First 28 000	0
Next 12 000	12
Next 10 000	24
Next 10 000	34
Next 90 000	38
Balance over 150 000	40

### VAT

The annual-threshold for exemption without the right to deduct relating to small manufacturers and small service providers has been increased from MAD 180 000 to MAD 500 000.

### Capital duty

The rate of capital duty, payable on incorporation and increases of capital, has been reduced from 1.5% to 1%.

### Tax procedures

The Moroccan tax authorities have been given the power to require companies subject to Moroccan tax to provide information concerning their transactions with non-Moroccan companies, in relation to:

- The nature of the relationship between the Moroccan company and the foreign company
- The nature of the goods or services involved in the transaction
- The method of determining the agreed price and supporting documentation
- The nature and extent of the foreign taxes to which the foreign counterparty is liable

Companies served with a notice to provide this information have 30 days within which to respond. Failure to do so leads to treatment of the two parties as related.

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## Netherlands

# 'Interest box' proposals reissued

On 14 June, the Netherlands government issued a consultative document proposing new rules for the taxation of group financing and holding activities. The proposals include a new version of the 'interest box' providing for an effective rate of tax of 5% on qualifying financing activities, but also restrictions on the deductibility of interest expense. The document also contains proposed rules further simplifying application of the participation exemption for corporate shareholdings.

### The interest box

Under the interest box, which would be mandatory, interest received by a company from loans to related parties and interest paid to related parties would be netted off in a 'box' and the net income would be subject to a special rate of corporate tax of 5%. Where there is a net deduction, this would also be limited to 5%.

Currently, related-party interest income is taxable and related-party interest expense deductible, at the normal corporate tax rate of 25.5%. Where a company has net related-party interest income, therefore, the proposed rules would result in lower taxation.

### Restrictions on interest deduction

The deduction of interest payments is subject to transaction-based anti-avoidance rules and thin capitalisation rules. The proposed changes would replace the thin capitalisation rules in one of two ways:

1. Interest paid would not be deductible if and to the extent that the loan finance relates to either (a) shares in subsidiaries qualifying for the participation exemption or (b) related-party loans.

The deduction of interest would also be restricted in cases of leveraged acquisitions using a Netherlands holding company included in a 'fiscal unity' (consolidated tax group) or merger

or

2. A general earnings-stripping rule, similar to that in Germany, would be introduced, under which net interest expense above 30% of EBITDA (earnings before interest and tax depreciation) would be disallowed.

Under both alternatives, exceptions would be made for net interest expense no greater than EUR 250 000. Under alternative 1, there would be a 3:1 debt-equity 'safe harbour' ratio as regards the leveraged acquisitions mentioned. Under alternative 2, there would also be a group-wide safe-harbour ratio.

## Participation exemption

Under current rules, dividends and capital gains from qualifying participations in other companies are exempt from corporate tax in the Netherlands. For a participation to qualify, it must essentially meet either a 'subject to tax' test or an asset test. Under the subject-to-tax test, the investee company's profits must be subject to an effective tax rate of at least 10% (for foreign companies, their taxable income is recalculated under Netherlands rules). Under the asset test, at least 50% of the aggregate assets of the investee company and any of its subsidiaries must be regarded as 'good'. Certain assets such as intra-group debts

and intellectual property licensed out to other group companies are regarded as 'bad'.

The new proposals would replace these rules with a simple portfolio motive test. If shares are held purely as portfolio investments, they would not qualify for the exemption, but otherwise it would apply.

## The way forward

The government has requested all parties involved to provide comments prior to 1 August 2009. Thereafter, the proposals will be finalised and the draft legislation submitted to parliament, with the aim that it should enter into force on 1 January 2010.

# Withholding tax exemption must apply to Iceland and Norway

The European Court of Justice (ECJ) has held that the exemption from Netherlands withholding tax on outbound dividends, as amended in 2008, must apply also to qualifying dividends to companies in Iceland and Norway.

After the ECJ decision in the *Amurta case* (C-379/05) in November 2007 (see *BDO World Wide Tax News 2007/4*), the Netherlands amended its law to align the qualifying conditions for the exemption as between dividends paid to other Netherlands companies and those paid to companies resident elsewhere in the European Union, as the ECJ required. However, the exemption did not and does not extend to dividends paid to companies resident in Iceland or Norway. Such dividends were or were not exempt according to the provisions of the tax treaties with those countries.

Iceland, Norway (and also Liechtenstein) are parties together with the Member States of the European Union to the treaty on the European Economic Area (EEA). Under the EEA Treaty, certain of the benefits and obligations of the EC Treaty and EC Directives are extended to the other three states.

In the present case, the European Commission considered that, by not extending the withholding-tax exemption under the same conditions to companies in Iceland and Norway the Netherlands was in breach of the free movement of capital article in the EEA Treaty (substantially the same as the equivalent article in the EC Treaty). Under the Netherlands' tax treaties with Iceland and Norway, the minimum shareholding for exemption was 10% and 25% respectively, whereas the minimum within the European Union was 5%.

The Court was silent on the question of dividends to Liechtenstein companies, and the Netherlands has no tax treaty with Liechtenstein. It remains unclear whether companies in Liechtenstein should be granted the same advantages as companies located in Norway and Iceland as there is no exchange of information with the tax authorities in Liechtenstein.

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## Poland

# EU interest and royalty rate falls to 5%

As part of the transitional arrangements for full compliance with the EC Interest and Royalties Directive (2003/49/EC), the rate of withholding tax on qualifying payments of interest and royalties decreased to 5% on 1 July 2009. Withholding tax on these payments will be abolished altogether from 1 July 2013.

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## Portugal

# EU interest and royalty rate falls to 5%

As part of the transitional arrangements for full compliance with the EC Interest and Royalties Directive (2003/49/EC), the rate of withholding tax on qualifying payments of interest and royalties decreased to 5% on 1 July 2009. Withholding tax on these payments will be abolished altogether from 1 July 2013.

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## United Kingdom

# CFC enquiries valid

The Court of Appeal in the United Kingdom has overturned the High Court decision in the *Vodafone 2* case and held that the tax authorities' inquiries concerning controlled foreign companies (CFCs) in an EU/EEA jurisdiction are valid.

Following the judgment of the European Court of Justice in the *Cadbury Schweppes* case, in which the Court held that the United Kingdom's CFC rules could apply in the case of CFCs resident in another EEA state only where the CFC had no genuine economic substance, *Vodafone* had applied to the UK courts to quash inquiry notices formally issued to it by HM Revenue & Customs (HMRC). The notice required *Vodafone* to provide information concerning its CFCs in the European Economic Area. *Vodafone's* argument, upheld by the High Court, had been that since the CFC rules contained no general exemption for companies located in the European Economic Area and carrying on genuine economic activities there, the rules were unlawful in their entirety vis-à-vis EEA countries, since it was not in the courts' power to 'read in' provisions not contained in the legislation.

The High Court had ruled in *Vodafone's* favour, but the Appeal Court has now held to the contrary. HMRC had the right, the judges ruled, to enquire into the activities of CFCs in EEA as well as other jurisdictions. In a more controversial part of the judgment, they also held that, per contra, it was possible to interpret the CFC legislation in such a way that it was compatible with the *Cadbury Schweppes* decision by reading in a further exemption for genuine economic activities.

Whatever the ultimate result of this case, it is still absolutely clear that companies with subsidiaries incorporated and carrying on genuine economic activities in the European Economic Area can legitimately claim that any CFC apportionment in relation to those subsidiaries is an unlawful restriction on their freedom of establishment.

However, companies whose activities amount to wholly artificial arrangements are not able to benefit from EC Treaty protection, and therefore remain subject to potential apportionment under the CFC rules.

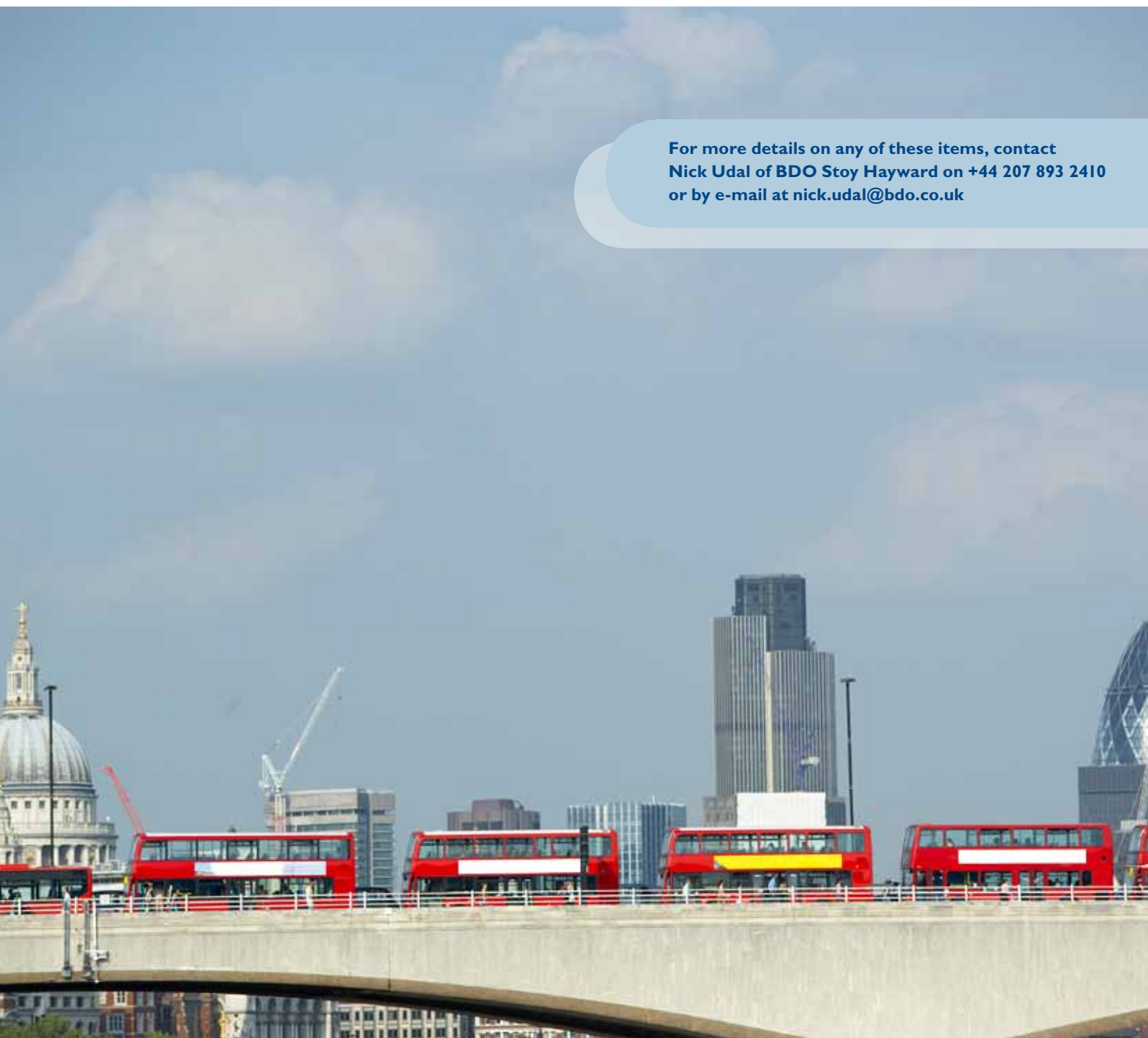
The *Vodafone 2* case resolves a procedural point (subject to further appeal) but the critical question as to the boundary between protected genuine economic activities and wholly artificial arrangements remains to be addressed in the pending *Cadbury Schweppes* case before the court of first instance (the First-Tier Tribunal).



The position can be summarised as follows:

- HMRC is entitled to enquire into the facts in relation to a potential CFC based in the European Economic Area to establish whether it represents a wholly artificial arrangement or conversely whether it is properly established in the other state and conducting genuine economic activity
- The focus of the CFC litigation now returns to the Cadbury Schweppes case to examine the criteria for determining the boundary between a wholly artificial arrangement and genuine economic activity
- The precise method of exempting the profits of a CFC carrying on genuine economic activities in the European Economic Area remains unclear, as there is no exemption for such cases written into the legislation
- Taxpayers based in the United Kingdom should continue to resist any CFC apportionments relating to EEA subsidiaries, as in our view, the test for genuine economic activities is low. However, queries from HMRC in this area are legitimate

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# Asia Pacific

## Australia

### Budget in challenging times

Delivered to Parliament in May in what the Treasurer (Minister of Finance) himself described as “the most challenging global economic conditions since the Great Depression”, the Australian Federal Budget contains the following proposals of most interest from an international perspective:

- Changes to the foreign-source income and anti-deferral rules
- Removal of the exemption for Australians working overseas
- Amendments to employee share schemes
- A new tax credit system for research and development and

#### Anti-deferral rules

The anti-deferral and foreign-source income rules are anti-avoidance legislation relating to investments by groups of companies in offshore subsidiaries.

Currently, Australia has four entity-deferment régimes — the controlled foreign company (CFC) rules, the foreign investment fund (FIF) rules, the transferor-trust régime and the deemed present entitlement rules. The complicated nature of these rules and their stringent application has historically imposed severe restrictions on Australian companies expanding overseas. The Government has announced that it will adopt most of the reforms proposed in a recent review of these rules.

Following consultation, the Government intends to:

- Modernise the CFC rules
- Repeal the FIF rules and replace them with a specific narrowly defined anti-avoidance rule
- Repeal the deemed present entitlement rules and
- Amend the transferor-trust rules to enhance their effectiveness and improve their integrity

When these measures are ultimately enacted, there should be significant compliance-cost savings for Australian companies with foreign activities, as well as opportunities to expand overseas without unnecessary hindrance from the anti-deferral rules. Groups will need to monitor the new rules as draft legislation is released and consider the opportunities that arise.

#### Employee share schemes

Currently, an employee who acquires shares or rights at a discount under a qualifying employee share scheme can either:

- Elect to be taxed immediately on the discount in the year in which he or she receives the shares or rights and benefit from an exemption of AUD 1000 or
- Make no election, so that the tax point is deferred until a later trigger point, such as the removal of any restrictions applying to the shares or a disposal of the shares or rights

Under the Budget proposals, as subsequently modified, shares or rights acquired after 30 June 2009 will fall under new rules. These provide that the AUD 1000 exemption will be available solely to employees with adjusted taxable incomes of less than AUD 180 000.

In all other cases, the full discount will be included in the employee's assessable income in the year in which the shares or rights are acquired (i.e. there will be no deferment of the tax point) except in certain specified circumstances. There would, for example, be a limited deferment of the tax point for schemes where there is a genuine risk of forfeiture. There would be no deferment, however, for shares or rights that have vested, as there is at present.

This means that, with limited exceptions, all employees will be taxed on the discount at which the shares or rights are awarded in the year of the award, and may thus be required to pay tax before the shares or rights can be realised. Although the Government has modified its original proposals somewhat, the overall effect is still bound to make employee share schemes less attractive. Foreign companies with Australian employee share schemes should immediately review the proposals and their likely impact on any future awards to employees in or transferring to Australia. It is worth noting that the new rules would also have a beneficial effect for expatriates transferring to Australia in that options granted before arrival may not be in the Australian tax net upon exercise.

### **Australians working overseas**

Currently, income earned by an Australian resident while working abroad for at least 91 continuous days is exempt from Australian tax if subject to tax in the jurisdiction in which the employment is exercised. Under the Budget proposals, the exemption will be limited to aid workers, charitable workers, certain government employees and employees working on certain projects defined as being in the national interest. In all other cases, the income will be taxable in Australia (unless a tax treaty provides otherwise).

The new rules may result in double taxation of the same income. Despite the possibility of a foreign tax credit for the tax paid abroad, the effect of the filing

timetable for Australian tax returns and the fact that different countries have different tax years may result in substantial periods in which tax is paid in two countries on the same income.

### **Research and development (R&D)**

The current R&D tax concession will be replaced by a tax credit system from 1 July 2010. The main features of the proposed new system are:

- A 45% refundable tax credit for qualifying expenditure by Australian-owned businesses with a turnover of less than AUD 20 million (and no expenditure cap)
- For businesses with a greater turnover, there will be a 40% non-refundable credit (equivalent to a tax deduction of 133%). This will also be available to foreign-owned businesses conducting research in Australia
- The definition of what constitutes qualifying R&D may be more restrictive than the current eligibility criteria
- As a transitional measure, the existing threshold for R&D expenditure qualifying for the R&D tax offset will be increased from AUD 1 million to AUD 2 million
- The current 175% tax premium will be abolished

The proposed credit system will be more advantageous to small and medium-sized enterprises currently conducting R&D activities. Larger claimants may be disadvantaged by the removal of the tax premium. There could be significant opportunities for foreign companies to operate their Australian and global R&D programmes from Australia.

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## People's Republic of China

# New rules for corporate reconstructions

The Chinese tax authorities (SAT) have issued a Notice (*Cai Shui* (2009) No 59) providing guidance on the tax treatment under the Enterprise Income Tax Law of corporate reconstructions.

According to Notice 59, a corporate reconstruction is an extraordinary transaction by which the legal or economic structure of an enterprise is significantly altered. The Notice lists the following forms of reconstruction:

- Exchange of shares (equity acquisition)
- Transfer of assets (asset acquisition)
- Merger
- Demerger (split-off)
- Debt restructuring
- Change in legal form

There are two types of treatment for reconstructions — 'general' tax treatment and 'special' tax treatment. One key difference between them is the timing of the recognition of gains and losses arising from the transfer of shares or assets.

Under the general tax treatment, gains or losses from the transfer of shares or assets at fair value are recognised immediately when the transfer occurs.

Under the special tax treatment, all or most such gains and losses are generally not recognised until the shares forming all or most of the total consideration for the transaction are disposed of.

### Tax deferral

Enterprises may elect for special tax treatment only if all of the following conditions are met:

- The reconstruction has a reasonable business purpose and its primary purpose is not reduction, deferral or avoidance of tax
- The assets or shares transferred must constitute at least 75% of the total assets or shares of the companies concerned
- Consideration in the form of shares must constitute at least 85% of the total consideration
- There is no change in the business activities of the transferor or transferee companies for at least 12 months following the reconstruction and
- The original principal shareholders who receive the equity consideration do not dispose of the equity (shares) so received for at least 12 months following the reconstruction

Gains and losses attributable to consideration other than shares is recognised immediately, however, and the following formula is used to compute the gain or loss:

$$\text{Gain or loss} = \frac{(\text{FV} - \text{BV}) \times \text{NEC}}{\text{FV}}$$

where

FV = Fair value of shares or assets transferred;

BV = base value of shares or assets transferred; and

NEC = value of non-equity consideration.

## Cross-border reconstructions

Taxpayers may also elect for special treatment for cross-border reconstructions, but in that case, additional conditions may have to be met. Notice 59 covers three scenarios.

In a foreign-to-foreign transfer, in which one foreign company transfers its shares in a Chinese enterprise to its wholly owned foreign subsidiary, the transfer must not cause a change on the Chinese capital-gains withholding tax on a subsequent transfer of the shares by the wholly owned subsidiary, and the transferor company must undertake not to dispose of its shares in the wholly owned transferee within three years of the reconstruction.

A foreign-to-China transfer is considered to take place where a foreign company transfers its shares in a Chinese enterprise to its wholly owned Chinese subsidiary. In such a case, no further conditions need to be met for the election for special treatment to be available.

A China-to-foreign transfer is considered to take place where a Chinese company uses its own assets or shares to invest in a wholly owned foreign subsidiary. In such a case also, no further conditions need to be met.

## Conclusion

Notice 59 repeals some of the favourable tax treatments available under former circulars. It sets out new general guidance for the tax treatment of corporate reconstructions and provides opportunities for deferring tax on a reconstruction. Some uncertain issues still exist, and need further clarification. It is expected that further Circulars will be issued in due course.

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## India

# Withholding tax on employment income

A recent decision of the Indian Supreme Court will require that tax be withheld from employment income relating to Indian duties even where the remuneration is paid by a non-Indian entity.

In a series of cases, the Court was faced with a fact situation where organisations working on a joint-venture basis employed individuals with a single employment with duties undertaken in India but whose salaries were paid partly by an Indian entity and partly by a foreign entity.

The Court held that Indian salary withholding tax applied equally to that part of the remuneration paid by the foreign entity.

Tax was already being paid in advance in the cases in question, but the Court ruled that withholding tax and the related withholding régime should apply instead.

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# Mauritius

## Six-month budget

Among the measures announced in May by the Mauritius government in its budget for the six months to 31 December 2009 were the following:

- The special levy on banks is increased to 1% on turnover and to 3.4% on profits, for the next two years
- Companies will be required to spend 2% of their profits on approved corporate social responsibility programmes
- Profitable telecommunications providers will have to pay a solidarity levy of 1.5% on turnover and 5% on profits, for the next two years
- The Income Tax Act is to be amended to allow the tax authorities to exchange information on non-residents with foreign tax authorities
- There will be a single 5% rate of land transfer tax until 31 December 2010

Publication of the Finance Bill incorporating these proposals and any possible modifications is expected on Friday 10 July, shortly after this issue of *BDO World Wide Tax News* goes to press.



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## Singapore

# Limited partnerships introduced

The Limited Partnerships Act 2008 took effect on 4 May 2009. Under the Act, this particular form of business is introduced into Singapore for the first time. As elsewhere where limited partnerships exist, the partnership must have one or more limited partners and one or more general partners. The limited partners are liable for the debts incurred by the partnership only to the extent of their capital contribution, whereas the general partners are jointly and severally liable for all the partnership's debts. The limited partners may not take part in the management of the partnership.

For tax purposes, a limited partnership will be treated as transparent, so income tax on the profits will be payable at the level of the partners. As with the partners in a limited-liability partnership (LLP — introduced in Singapore in 2005), the limited partners in a limited partnership face restrictions on the extent of losses and capital allowances (tax depreciation) they may deduct. There is no such limitation on the general partners.

## Temporary liberalisation of foreign-source income exemption

Currently, all foreign-source income remitted to Singapore by individuals (other than partners in a Singapore partnership) is exempt from Singapore tax. Under the FSIE (foreign-sourced income exemption) Scheme, certain foreign income of residents other than individuals and of resident individual partners in a Singapore partnership ('specified resident taxpayers') is also exempt if certain conditions are satisfied.

The foreign income concerned consists of dividends, branch profits and income from professional, consultancy etc services supplied from a fixed place of operation outside Singapore. The conditions are that tax must have been paid in the foreign jurisdiction, that the headline rate of tax on that income when received is not less than 15%, and that the Singapore tax authorities are satisfied that the exemption would be beneficial to the taxpayer.

To help businesses make the best use of all their sources of funds, including prior years' foreign income kept outside Singapore, during the current financial crisis, the government has announced a temporary expansion of the FSIE.

The FSIE is extended to include all foreign income accrued before 22 January 2009 and received in Singapore by specified resident taxpayers in the period from 22 January 2009 to 21 January 2010. Furthermore, for that period, both the requirement that tax have been paid and that the headline rate of that tax have been no less than 15%, has been dropped. This means in particular that income such as interest, rent and royalties, which is normally outside the scope of the FSIE may be remitted to Singapore free of tax during the one-year exemption period.

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## Thailand

# Reduced property fees extended

Reduced registration fees of 0.01% for the transfer or mortgage of certain immovable property have been extended for a further year, to 28 March 2010.

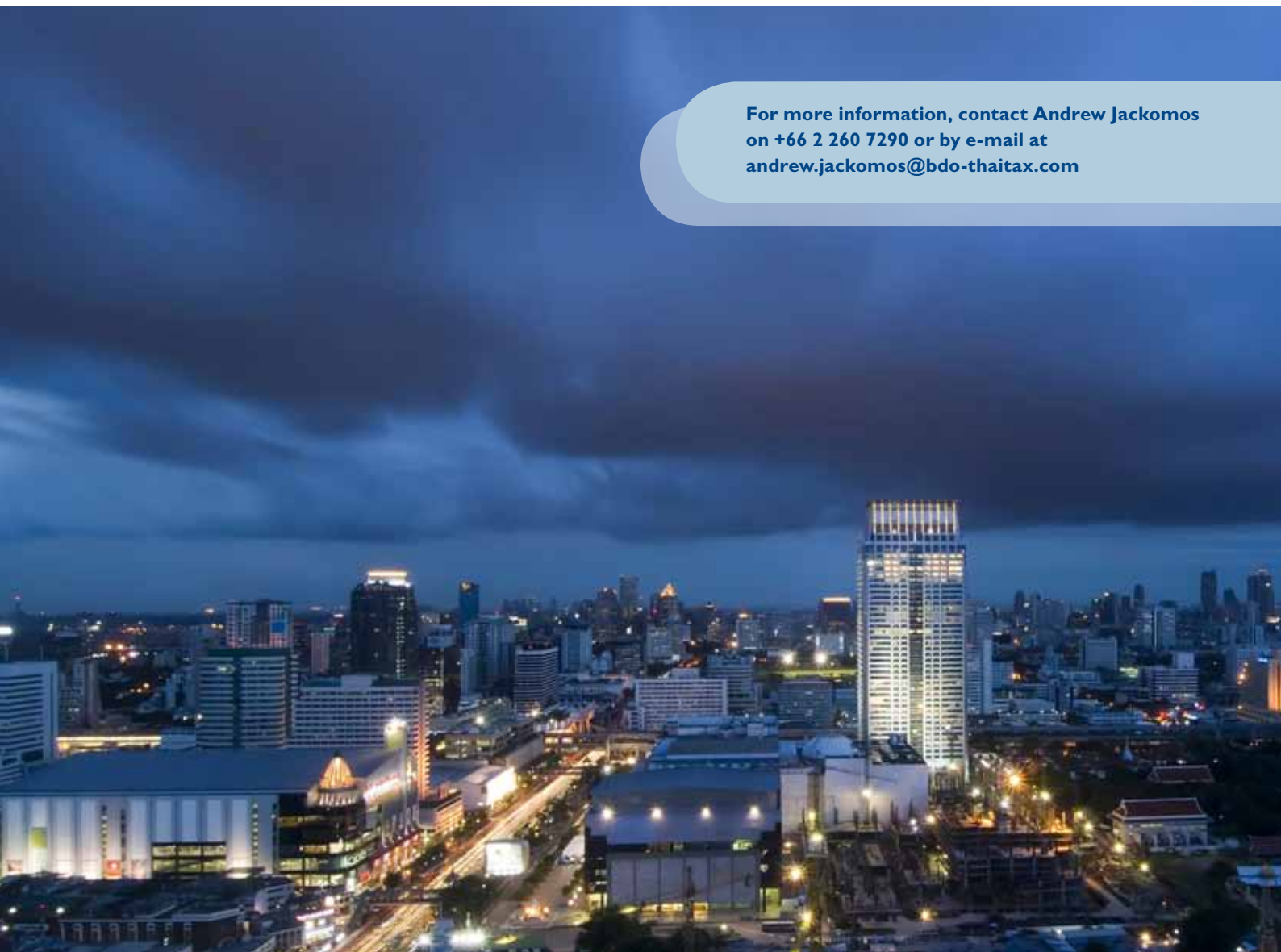
The property affected includes registered entire condominium buildings and certain land allocated for housing, shops or commercial buildings.

# Delay in implementing SBT reduction

The rate of specific business tax (SBT) on the sale price of immovable property was reduced from 3.3% to 0.11% for sales registered between 29 March 2008 and 28 March 2009. The Government had announced its decision to extend the reduced rates for a further

year, but this is yet to be implemented in law. Tax will therefore be collected at 3.3%, but taxpayers will be entitled to claim a repayment once the legislation is in effect.

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## Sub-Saharan Africa Zimbabwe

### Taxes payable in foreign currency

The Unity Government's Budget for 2009 was enacted on 23 April 2009. The most significant change contained in the Finance Act 2009 is that all tax must be paid in foreign currency.

The Zimbabwe dollar (ZWD) it should be noted was revalued in August 2008 by the removal of the last ten zeros (equivalent to ten thousand million) and again on 2 February 2009 by the removal of a further twelve zeros (equivalent to a million million). For all accounting and taxation purposes, final balances in Zimbabwe dollars (as revalued) are to be converted to USD at the rate of USD 1 = ZWD 20. The currency is no longer in use for most practical purposes.

Other features of the Budget and Finance Act are:

- The corporate tax rate remains at 30.9% (30% + 3% Aids levy), as does the income of individuals or trusts from trade or investment
- The top marginal rate of income tax on individuals has been reduced from 48.925% to 38.625% (including Aids levy)
- With effect from 30 January 2009, the VAT registration threshold is set at USD 60 000 and a mid-term VAT payment falls due on the 15th day of the tax period
- With effect from 1 February 2009, the estate-duty threshold is USD 50 000
- The customs-duty suspension on basic commodities was extended to 31 July 2009.



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## Middle East Oman

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### New corporate tax law

The much-awaited new Income Tax Act has been promulgated by Royal Decree, and becomes effective on 1 January 2010. The new law provides clarity on several existing provisions, eliminates disparity in the rates of tax charged on local and foreign companies, confirms the practice being followed by the tax authorities and harmonises tax law and double tax treaties between Oman and many foreign countries.

In short, inter alia, the new law:

- Establishes a single 12% tax rate for all business taxpayers
- Establishes a global system of taxation
- Establishes a 90-day threshold limit for determining the presence of a permanent establishment of a foreign entity providing services
- Simplifies the tax-depreciation rules by adopting the concept of pooling of assets
- Provides for the deduction of pre-incorporation expenses
- Establishes restrictions, still to be defined by an Executive Regulation, on the allowance of head-office overheads, transfer pricing and related-party interest payments
- Confirms the taxability of foreign dividends
- Provides for a foreign tax credit for tax paid abroad and
- Provides for reciprocal treatment in the other related party's assessment for (transfer pricing) adjustments made for related-party transactions

Some of these points are discussed further below.

#### Territorial basis of taxation replaced

The territorial system of taxation, under which only income derived in Oman was taxable, is abolished and replaced by a residence-based system. Under the new rules, Omani proprietorships and Omani companies are liable to tax on all their income wherever earned.

#### Permanent establishments

A foreign entity engaged in business activity in Oman via a dependent agent could be deemed in certain circumstances to have a permanent establishment in Oman. The dependent-agent rule is new to Omani law. A further innovation in this area is that a foreign person providing services will be deemed to have a permanent establishment in Oman if his stay in Oman exceeds 90 days in any 12-month period.

#### Taxable income and gains

Taxable income will specifically include income earned prior to incorporation. By the same token, non-capital expenses incurred before incorporation may be deductible.

Capital gains, wherever derived, will also be subject to tax. This includes gains made by a permanent establishment on disposal of its operations in Oman.

#### Single tax rate

Under existing law, companies and proprietorships registered in Oman or another GCC (Gulf Cooperation Council) state pay tax at 12% on all taxable income over OMR 30 000. Foreign non-GCC companies, however, pay at progressive rates of up to 30%. Under the new law, all taxable entities pay 12%, with an initial exemption of the first OMR 30 000.

# Currency comparison table

Below are illustrative exchange rates against the euro and the US Dollar for the currencies mentioned in this issue, as at 3 July 2009.

Currency unit		Value in euros (EUR)	Value in US dollars (USD)
Australian dollar	(AUD)	0.5698	0.7969
Danish krone	(DMK)	0.1343	0.1880
Euro	(EUR)	1.0000	1.3988
Pound sterling	(GBP)	1.1693	1.6356
Latvian lats	(LVL)	1.4399	2.0139
Moroccan dirham	(MAD)	0.0892	0.1247
Omani rial	(OMR)	1.8627	2.6052
US dollar	(USD)	0.7156	1.0000

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